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PENDING CONGRESSIONAL LEGISLATION AS AFFECTING OWNERS OF RAILROAD SECURITIES

S. DAVIES WARFIELD

President National Association of Owners of Railroad Securities;
President The Continental Trust Company, Baltimore

ON November 12th a statement appeared in the press signed by the chief executives of organizations of railroad workers, including three of the four principal brotherhoods. This statement, in denouncing the labor clauses of the Esch Bill, characterized it as a "conscienceless betrayal of the public interest;" that "it validates twenty billion dollars of railroad securities, at least eight billions of which is water;" that it caters to "Big Business" and that generally the measure is "vicious."

The statement continued: "This travesty on legislation reveals the fundamental weakness of all schemes to return the roads to their former owners. The fact is that private ownership of the means of transportation has broken down. . . ." That "apparently our statesmanship is as bankrupt as our railroads. . . ." That "the railroads should be held under federal control for at least two years," and in respect to government ownership it said that "labor is willing to accept the sober judgment of the American voters as expressed at a general election."

Esch Bill Stripped of Revenue Provision

Since this statement was made, the Esch Bill has passed the House stripped of the provision which the Committee of the House that framed the bill thought would enable rates to be made which would ensure sufficient revenue properly to operate the railroads. The defeated section read thus:

"In reaching its conclusions as to the justness and reasonableness of any rate, fare, charge, classification, regulation, or practice, the Commission shall take into consideration the interest of the public and the shippers, the reasonable cost of maintenance and operation (including the wages of labor, depreciation, and taxes) and a fair return upon the value of the property used or held for the service of transportation."

Under the bill as amended and passed the inefficient rate laws

stand as at present constituted, with the wage dispute adjustment provision incorporated therein demanded by the chief executives of the brotherhoods.

The failure of a rate-making formula to pass the House substantiates our contention that the Act should *definitely* interpret what a "reasonable" rate means by naming the minimum and provide for a maximum return from such rates, as the only practical legislative solution of the railroad problem. Definite directions in the act in respect to these essentials are as necessary to satisfy the demands of the public, the apprehensions of the shippers and the caution of Congress as it is to be certain that the railroads will be enabled to give adequate service, as a whole, and finance themselves. To state that rates shall be made that will "produce reasonable return" adds nothing to the bill or to the present law that has not been considered by the Commission in the past in making rates as pointed out by Commissioner Clark at a hearing before the House Committee.

The specific charge in respect to railroad securities made in the statement by the organization of railroad workers referred to requires answer. The charge is that the Esch Bill (before amendment), clearly meaning any legislation giving financial protection, "validates approximately twenty billion dollars of railroad securities, at least eight billions of which is water, and directs the Interstate Commerce Commission to tax the American people through an increase in freight and passenger rates to pay dividends on those 'shadow dollars.'"

Any such characterization of railway value is untrue and is but one of many evidences of a deliberate determination by violent terms and action to attempt to coerce and demoralize Congress so that no constructive railroad legislation shall pass. By these irresponsible representations as to values and denouncement of the Congress where they say "statesmanship is as bankrupt as our railroads," and by abusive criticism of proposed legislation inconsistent with their own, those issuing the statement have apparently succeeded in defeating the meagre financial provisions in the Esch Bill, and hope to destroy the enterprise which employ the men they purport to represent in order that they may gain its possession.

The reckless charges in respect to the value of the securities of the railroads are but a repetition of similar misstatements in connection with railroad legislation which for months has been

before committees of both the Senate and the House of Representatives.

Property Accounts Represent Less Than Aggregate Value

The property investment accounts of the railroads have been under the close supervision of the Interstate Commerce Commission only since 1907, yet within the short intervening period of twelve years the records show that more than six billion dollars of cash expenditure has been made on the properties of Class I railroads, over one-third of the seventeen and a half billion dollars total property book value of these roads, exclusive of inter-company securities (as of the test period 1915-16-17). I am speaking of property value not security values or issues. No well-informed person will contest the statement that *in the aggregate* the properties and equipment devoted to the public use of Class I railroads (89 per cent of the total mileage) are worth more in the aggregate than the seventeen and a half billion dollars, as shown by the books of the railroads.

But whether this be true or not true, the billions of alleged "water" and "shadow dollars" are effectually provided against in Section 6 of the Cummins Bill, now awaiting action by the Senate.

The importance of the provisions of this section of the Cummins Bill as the minimum essential to the continuance of the development and prosperity of the country cannot be too strongly urged upon Congress, upon the shipping interests and the public. It now stands alone between a successful transportation system privately owned and operated, and a government system, how operated you cannot know.

Fair Value of Railroads Taken as Basis for Return

The effect of Section 6 of the Cummins Bill is to provide that, pending actual physical valuations of all railroad properties, the Interstate Commerce Commission, taking into consideration all the elements that should properly be considered, shall determine the "fair value" of the property and equipment of the railroads, in the aggregate, in each rate group. For the purpose of determining and adjusting rates so that they will yield a living and fair return, the Commission shall group the roads (as they have done in the past for a similar purpose) into as many groups as they may decide. Upon the aggregate amount of the investment in or "fair value" of all the railroads of each group a

level of rates shall be established that will yield "as nearly as may be" $5\frac{1}{2}$ per cent. on this aggregate value, plus one-half of 1 per cent. at the discretion of the Commission, for unproductive improvements, which in the case of those roads earning over 6 per cent. on value determined as stated—not on securities—shall not be capitalized for future rate making.

Earnings that may be made by any railroad in excess of the 6 per cent. (on value) and up to 7 per cent. are divided one-half to the railroad earning them as incentive, the other half to be used as a national fund administered by a government authority in the interest of transportation as a whole, for joint terminals and other joint facilities, or for cars and equipment to be leased to roads to relieve congestion, but not to be capitalized in future rate making. Thus there is a division of excess earnings beyond the given reasonable return on "fair value," between those who use the railroads and those who own them. The one-half of the excess which goes to the road earning it is credited to a reserve account to be used, under specific conditions, to enable it to meet financial obligations and in lean years to provide against deficiencies which might impair its obligations to the public. After 7 per cent. is earned by any road the ratio of division becomes one-third to the railroad earning it and two-thirds to the transportation fund.

*Section 6, Cummins Bill, Provides Against So-called
"Watered Securities"*

Under Section 6 of the Cummins Bill, *the aggregate value* of the roads of the respective groups is taken. Rates are based on such value, without respect to the amount of securities which may have been issued by any railroad. Since the public and shipper would pay only a reasonable return on the value of each group of railroads as determined by public authority and get back part of what they pay to maintain transportation as a whole, in the use of the facilities purchased from the general transportation fund created from excess earnings, the misrepresentations that have been made and the clamor of the past that the public pays returns on false investment would end. If this section of the Cummins Bill becomes the law, the idle talk about paying or earning "dividends" or a return on "watered securities" and "shadow dollars" will cease and private ownership and operation will be permanently established.

Many railroads will not earn as much as the $5\frac{1}{2}$ or 6 per cent. on their *individual* property and equipment which would go to make up part of the aggregate of the railroad property in their respective groups. Rates being made on the *aggregate value of all* the property of a *group*, each railroad earns on its *own value* as much as it can secure through efficiency in operation and management. So a railroad that is overcapitalized in securities suffers in the percentage return it would receive on *such securities* because the return is based on the "fair value" of its *property* and *equipment*. No greater incentive could be given to each railroad than to require that its earnings from rates made on the aggregate value of *all*, shall depend entirely upon its own efficiency, and not upon a guaranteed *amount* to each or a government guarantee *security*. Those roads that earn over 6 per cent. on the value of their property have the incentive to make the earnings in excess thereof as great as possible, because they retain one-half of such excess between 6 and 7 per cent. and one-third after 7 per cent. So there is no *guarantee* of any description, directly or indirectly, given. Rates are made that would yield the stated return on the value of the transportation system *as a whole* and no two roads will necessarily receive the *same percentage* return, because each earns on its *own value* what it can from rates made for *all*, the leveling is accomplished through the regulation of earnings in excess of the percentage return.

Director-General Hines' Prediction

The Esch Bill now passed by the House does not contain, nor did the unamended bill contain, any permanent financial provision for the railroads. It does not nor did the original bill provide for the regulation of excess earnings, essential to produce a uniformly efficient service throughout our transportation system. Such regulation becomes necessary because railroads that serve dense traffic territory can earn more from a rate than those serving sparsely settled territory, and the latter constitute the majority of the railroads (Class I). You cannot make rates that will suit all the railroads alike. A rate level that will enable the great majority of railroads to live must necessarily produce more earnings to roads serving dense traffic territory than such roads are entitled to have and more than they would receive but for the necessities of the majority. The Commission in the past has hesitated to allow rates that will give to a few favorably situated

roads inordinate earnings which the shippers and public served by these roads have repeatedly declared they will not stand for. Yet such a result is unavoidable under present laws if regard is to be had for the life of the majority which constitute those roads not so favorably situated as the few. The result has been that the Commission could not make rates that were necessary to the majority, so the railroads and the public have both suffered the consequences. Should this continue? If it does, Director-General Hines' prediction will come true when he said that—

The plan of private management necessarily involves the idea that if one or many railroad companies happen to be exceptionally prosperous, the entire exceptional profits remain with the railroad company. This condition, continues Mr. Hines, *will make the public always fear or suspect that it is being exploited through the transportation service for the benefit of private capital* and will lead to continual insistence upon the railroads being operated exclusively for the public benefit *through government ownership and operation.*

Mr. Hines recognized the necessity of excess earnings regulation.

Crux of Railroad Problem Solved by Section 6, Cummins Bill

At a hearing before the House Committee which framed the Esch Bill, in reply to a member of the Committee who after repeating substantially the provision relating to rates *then in the proposed bill*, whether such provision would change the past methods of the Commission for making rates, Commissioner Clark, a member of the Interstate Commerce Commission and Chairman of their Legislative Committee, stated that "it would not change it in substance, *because all of those things are now considered.*" In like manner, Commissioner Clark, when questioned upon the advisability of providing in the act a fixed percentage return on value ascertained by public authority which, as we have shown, carries with it regulation of excess earnings, stated, "*it would avoid endless controversies (and) it would put an end to interminable discussion and argument.*"

There is no higher type of man than the men who occupy responsible positions in the service of the railroads. From the locomotive engineer to the man who walks the track I do not believe one of them if fully informed would look for fairer protection to themselves and the public than is provided by Section 6 of the Cummins Bill. Shippers and the public are vitally concerned in this section, for unless adequate revenue is provided

for the railroads, now only to be had through definite requirements of a fixed return with a division and regulation of earnings in excess thereof substantially as Section 6 provides, their railroad service will break down, for another opportunity will not be afforded them for securing constructive legislation, and Government ownership will be forced upon them.

Whether all the existing railroads shall be ultimately forced to consolidate into twenty-five or thirty-five or two or three larger companies, or whether consolidations are made permissive (which we favor), it will require years of valuation, bargaining, and litigation in the case of the former, and considerable time in the case of the latter, so this is not the immediate issue. The crux of this problem lies in whether the principles laid down in Section 6 of the Cummins Bill are to be enacted into law as the only means to save the railroads on the termination of the proposed six months' extension of the standard return; or whether they shall be turned back to their owners loaded with debt, many of them, their traffic disrupted as the consequence of the necessary unification plans of the government incident to the war, with nothing to rely upon but the same regulating laws and procedure of the past, nothing definite upon which they can depend. Any legislation embodying substantially what is now on the statute books, though it may contain added verbiage, will fail unless it empowers the Commission to adjust rates through the regulation of excess earnings of a comparatively few railroads, and to a fair and reasonably fixed initial return to all.

Section 6 of the Cummins Bill is a constructive step in recognizing that the impossible conditions which existed in the past between the shipper and the carrier must be stopped that the business of transportation may be carried on in a business fashion. The mandate by Congress to the Commission comes as near producing an automatic adjustment of rates as possible, and will avoid the "endless controversies" (and) "interminable discussion," as characterized by Commissioner Clark.

*Securities Association Largest Organized Group of
Owners in Existence*

The National Association of Owners of Railroad Securities represents the largest single organized group of railroad securities in existence. They come nearer as an active force being the owners of the railroads than any other single organization. It

is not unreasonable for some of them at least to think that they should be listened to in respect to legislation by the operating heads of railroads that have sold them the securities they own, particularly when such legislation is financial. They find themselves opposed by a few executives who, in the name of their Executives Association, beginning with opposition to our efforts in securing adequate protective clauses in the standard form of government contract when the roads were taken over, are now in open hostility to the one thing the Securities Association chiefly stands for, namely, the principles involved in Section 6 of the Cummins Bill. The owners of the great majority of the outstanding securities of all the railroads find themselves in the unfortunate position of being called upon, through this Association, to defend their securities from attacks, when they had at least the right to expect that the presidents of the railroads that issued such securities should cooperate to secure the legislation the owners believe to be necessary. But these few executives in the name of and exerting the influence of their "Association of Railway Executives," though many executives of the member roads are not in sympathy with such action, are attempting to defeat the purposes of Section 6 of the Cummins Bill, the only constructive railroad legislation offered in years, and thereby find themselves unable to offer assistance. Their campaign in some instances is as misleading as that of the framers of the statement attacking the Esch Bill, and they are lending them assistance in establishing conditions which will not only work injury to those they are supposed to represent, but will eventually lead to government ownership. Their attitude is illustrated in a letter (among others received) from one of the prominent railroad presidents of the country. He asserts that the Executives Association is "dominated by certain interests who are largely responsible for the past and present difficulties of the railroads. In the present instance the Bourbons are running to form."

The Association believed the time had come when all that could be expected is a fair initial return with sufficient in addition above that return to preserve the incentive essential to efficient service. Inherent traffic and territorial difficulties demanded that the regulation of these properties must extend to the earnings in excess of this fair return. In the light of the experience of the past, we wish to see an end put to the "interminable discussions" as to rates that have occurred in the past before

the Commission, and the owners of the railroads should be willing to make sacrifices to secure it.

Dangers in the Situation

Millions of citizens, depositors in mutual savings banks and owners of policies in the great mutual life insurance companies, are represented through their companies as members, as are also those represented by investing institutions generally, all owning vast amounts of railroad securities and are vitally concerned in the pending legislation.

The propaganda being spread throughout the country aimed at the defeat of all railroad legislation, unless a partnership is created by Act between the brotherhoods and the government under government ownership, means that all the political force they can muster will be used against members of Congress who decline to accede to their demands.

Representatives in legislative bodies should be brought to feel that they are not to be left to be beaten because, without fear or favor, they fulfill their obligations of office. Unless these conditions are recognized our institutions will be seriously impaired. There is every indication that the public expects to see the railroad problem solved and settled permanently. Anything less than the requirements of Section 6 of the Cummins Bill will not meet their expectations.

The rank and file of the employees of the railroads, when made conversant with actual conditions, cannot sanction the methods being used to defeat constructive legislation which will solve the railroad problem, with due regard for all interests and classes. The rank and file should know that in the division of excess earnings our original proposal was that any excess over the fixed initial return should be divided one-third to the railroad earning such excess, one-third to a fund in the interest of railroad employees and one-third to the national fund created to be spent in the interest of transportation. The Brotherhood chiefs opposed this, they did not favor the employees having a participation in earnings under private ownership. So this was abandoned.

The time has arrived when the trustees of those representing the great mutual investing institutions should have their dependents know the extent to which this propaganda and these purposes have reached, and what it means to the thirty-three million holders of life insurance policies, to the millions of depositors in

savings banks, to individual investors and others. We live under a partisan political government, and unless those who represent these millions of owners meet the situation by giving support to those public servants who strive to do their duty, a small minority of the electorate, through the propaganda now being spread throughout the country, will bring about the destruction not alone of the rights of property, but the very foundation of our Government.